Fort Washington
Investment Advisors, Inc.

A member of Western & Southern Financial Group

As Waves of Change Overtake the Cash Market, Investors are Seeking Solutions

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An interview with Scott D. Weston, Managing Director and Senior Portfolio Manager with Fort Washington Investment Advisors, Inc.

Why is now a critical time to think about cash management?

Three major events are on a collision course that could create the perfect storm in the world of cash. The confluence of Money Market reforms, regulatory changes from Basel III, and rising interest rates have brought the cash markets to a major inflection point. An estimated $3 trillion will potentially change hands while looking for an alternative to the once standard parking spots in Prime Money Funds or large institutional deposits.

How can investors respond to these events?

In our view, investors will be forced to pay attention to their cash allocation, an asset class that is often overlooked. Firms that offer cash alternatives may offer significant value.

We believe our Ultra Short Duration strategy is a viable alternative to Prime Money Market Funds and institutional deposits for investors seeking more attractive yields.

We view this strategy as an extension of the money market sector, offering the potential for additional returns in exchange for a modest degree of price volatility. The buy and hold approach produces a portfolio with significant first-year maturities, generating reinvestment opportunities and reducing price volatility.

The strategy seeks to maximize total return consistent with the preservation of capital by investing in a diversified portfolio of investment grade securities with a weighted average portfolio duration of less than one year.

What securities does the strategy invest in?

The strategy utilizes a multi-sector approach and emphasizes structured products — which historically have produced high alpha and Sharpe ratios through both interest rate and credit cycles. The strategy will invest in the following securities:

- U.S. Treasury securities
- U.S. government agency securities
- U.S. government-sponsored enterprise securities
- Corporate bonds
- Mortgage-backed securities
- Commercial mortgage backed securities
- Asset backed securities
- Municipal bonds
- Cash equivalent securities

What is the time horizon for your investment?

While the strategy may invest in securities with any maturity or duration, interest rate risk is managed by maintaining an effective duration of one year or less under normal market conditions.

How does your investment philosophy seek to exploit market inefficiencies?

In structured securities, where loan-level information is available, it is possible to glean insight into expected loan (and security) performance. We consider our ABS, RMBS and CMBS sector management capabilities to be very robust with strong front-end due diligence and back-end surveillance processes. Additionally, the preference for taking liquidity risk in high quality structured securities versus taking credit risk in lower quality bonds is offset by the high cash flow emphasis and has historically produced high nominal and risk-adjusted returns.

How do you believe your process takes advantage of these inefficiencies?

The investment process is multifaceted with emphasis on bottom-up security selection within a strategic sector allocation framework. Our perspective on macroeconomic fundamentals helps drive sector allocations and security selection, but does not result in aggressive duration shifts.

Within the individual sectors, the asset specialists combine deep knowledge of their markets and strong processes to assess the value of their sector and generate specific investment ideas based on many factors including relative value, predictability and stability of cash flow, liquidity, structure, and short-term market conditions. If a security passes this scrutiny, adheres to the strategy and client guidelines, and fits within the risk budgeting and tactical allocation frameworks, the security can be purchased.

What are the risks in the ultra short duration market?

The key risks in this market are similar to core bond portfolios (interest rate risk and credit risk), but the magnitude of these risks are mitigated substantially by the ultra short duration focus. Additionally, risk is acutely measured using conventional and proprietary risk metrics that incorporate historical correlations and allow the risk management team to project downside performance and volatility. Due to the high quality and short-duration focus, downside volatility in the strategy tends to be transient as the underlying securities mature at par.

How is your team structured?

The strategy is managed using a team approach including 9 sector specialists and 7 credit analysts. Each sector-focused team within Fort Washington's Fixed Income department has independent, dedicated research specialists. The specialists supporting the Ultra Short Duration strategy assist me and Brent Miller who, as co-portfolio managers, have final authorization and responsibility over security selection and portfolio construction.

In your view, how is the strategy and team positioned to take advantage of the changes in cash management?

The strategy leverages the firm's sector specialists as well as advanced evaluation and risk management capabilities in these increasingly complex markets.

The focus on, and depth of experience in, structured products makes us unique in the ultra short duration (USD) space. Management has performed extensive peer group analysis over the long term, through credit cycles and interest rate cycles, to gain insight into which sectors provide the best opportunity for risk-adjusted returns in the USD space. This insight has helped to shape the strategic focus which, when combined with granular fundamental analysis (loan-level when possible), has produced attractive Sharpe ratios historically.

Past performance is not indicative of future results. This is provided for informational purposes only and should not be considered as investment advice.

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